UNITED STATES DISTRICT COURT

DISTRICT OF MAINE

ROYAL BUSINESS GROUP, INC., et al.,	)	
	)	
PLAINTIFFS	)	
	)	
v.	)	**Civil No. 96-18-P-H**
	)	
PRETI, FLAHERTY, BELIVEAU & PACHIOS, ET AL.,	)	
	)	
DEFENDANTS	)	

ORDER ON DEFENDANTS PRETI, FLAHERTY, BELIVEAU & PACHIOS'S AND RICHARD SPENCER, JR.'S MOTION FOR SUMMARY JUDGMENT

The defendants' motion for summary judgment is **GRANTED** on Counts V and VI and **DENIED** on the other counts as follows.

COLLATERAL ESTOPPEL

Judge James B. Haines, Jr. entered a default judgment in the Bankruptcy Court against these plaintiffs (there the defendants) when the trustee in bankruptcy sued them for a fraudulent transfer. I affirmed the default judgment on appeal, Order, Royal Business Group, Inc. v. O'Donnell, Civ. No. 96-17-P-H (D. Me. Apr. 16, 1996), and my decision has now been appealed to the First Circuit. It nevertheless is a final decision for purposes of collateral estoppel analysis.

In the default judgment Judge Haines stated that he would "treat all well-plead [sic] factual allegations of the Amended Verified Complaint as true." Order, O'Donnell v. Royal Business

Group, Inc. (In re Oxford Homes, Inc.), No. 94-20135 (Bankr. D. Me. May 22, 1995) ¶ 22. He also stated that "the Court finds, based on the admitted allegations [admitted by virtue of default] in evidence, that the Defendants [plaintiffs here] acted with actual intent to hinder, delay, and defraud creditors of the Debtor . . . ." Id. ¶ 31. As a result, the trustee recovered judgment against these plaintiffs in the approximate amount of $4.6 million after various doubling calculations.

In this lawsuit the plaintiffs have sued the lawyers who represented them in the transaction that gave rise to the fraudulent transfer for professional malpractice[1] in failing to alert them to the problems with the transaction that got them into trouble. The lawyers have brought this motion for summary judgment claiming that Judge Haines's default judgment has finally and conclusively established that the plaintiffs knew of all the defects in the transaction at the time and therefore cannot recover against their lawyers for failing to advise them.

The fact that the lawyer defendants in this case were not parties to the lawsuit in the Bankruptcy Court does not prevent the application of collateral estoppel, for it is being asserted against the plaintiffs who were defendants in the Bankruptcy Court. Mutuality is no longer required. See Parklane Hoisery Co., Inc. v. Shore, 439 U.S. 322, 327-28, 99 S. Ct. 645, 649-50, 58 L. Ed. 2d 552, 559-60 (1979), citing Blonder-Tongue Labs., Inc. v. University of Ill. Found., 402 U.S. 313, 329, 91 S. Ct. 1434, 1443, 28 L. Ed. 2d 788, 799-800 (1971). Courts are, however, more careful about applying the doctrine where the previous judgment was obtained by default. See, e.g., In re Gottheiner, 703 F.2d 1136, 1140 (9th Cir. 1983); Massachusetts v. Hale, 618 F.2d 143, 146 (1st Cir. 1980). Some courts have held that although they would hesitate to apply the doctrine in a straight default situation because the defaulting party simply may have decided that the stakes in the previous

[1] Counts I through IV of the Complaint allege negligence, breach of contract and misrepresentation.

lawsuit did not justify litigating the issue there, see Restatement (Second) of Judgments § 27 cmt. e, they will nevertheless apply collateral estoppel where an appearance was entered and extensive litigation occurred, but the party ultimately defaulted. See, e.g., In re Daily, 47 F.3d 365, 368 (9th Cir. 1995); In re Bush, 62 F.3d 1319, 1323-25 (11th Cir. 1995). The First Circuit has not spoken except in Hale's dictum that more caution is advisable.

I conclude that I should not apply the collateral estoppel doctrine here. Although Judge Haines was well justified in ordering default judgment (as I ruled on the appeal), the case was then only in its beginning stages and contained overtures of a litigant taking advantage of his counsel's replacement in order to avoid coming to grips with the court's orders and procedures. I am not satisfied that what the plaintiffs here did as defendants in the Bankruptcy Court amounts to the full opportunity to litigate the issues in question which the doctrine of collateral estoppel contemplates in order to bar their future litigation. Accordingly, the summary judgment motion on this ground is **DENIED**.

FEDERAL SECURITIES LAW CLAIM

A one-year statute of limitations applies to the plaintiffs' federal securities law claim. The one year begins to run upon discovery of the facts constituting the violation and in any event within three years after the violation. Lampf, Pleva, Lipkind, Prupis and Petigrow v. Gilbertson, 501 U.S. 350, 361, 111 S. Ct. 2773, 2781, 115 L. Ed. 2d 321, 334-35 (1991). Inquiry notice is sufficient—specifically "(1) sufficient facts . . . to put a reasonable investor in plaintiff's position on inquiry notice of the possibility of fraud, and (2) . . . due diligence in attempting to uncover the factual basis underlying this alleged fraudulent conduct." Allied Inv. Corp. v. KPMG Peat Marwick,

872 F. Supp. 1076, 1081 (D. Me. 1995) (quoting Maggio v. Gerard Freezer & Ice. Co., 824 F.2d 123, 128 (1st Cir. 1987) (citation omitted)). As the First Circuit has said, "'storm warnings' of the possibility of fraud trigger a plaintiff's duty to investigate in a reasonably diligent manner[.]" 824 F.2d at 128. The defendants claim that the plaintiffs here were put on inquiry notice when they learned that the trustee was contemplating litigation against them for a fraudulent conveyance. Specifically, the defendants refer to a letter by the individual plaintiff Real O. Roy to the Bankruptcy Judge dated July 21, 1994, stating "Some time ago, I read in the newspaper that one of the attorneys for the Debtor stated that they would pursue legal action against Royal Business Group for having sold an insolvent company. This accusation has no basis and will only allow the lawyers to submit countless hours to the estate for unnecessary fees." This statement hardly suffices to show that the plaintiffs thereby had notice of their cause of action against their lawyers in the transaction such that the statute of limitations began to run on July 21, 1994.

The plaintiff Roy, however, filed an affidavit in this lawsuit on April 24, 1996. Roy also is the principal for the two corporate defendants. See Roy Aff. ¶ 1. In his affidavit at ¶ 11, Roy states: "I did not know or have reason to know until January 25, 1995, that my lawyers had failed to tell the truth about the transaction when I sold Royal's shares of Oxford." Court records reveal that the Complaint in this matter was filed on January 30, 1996. As a result, the action was not commenced within one year after notice. The motion is therefore **GRANTED** as to Count V.

MAINE SECURITIES LAW CLAIM

In Count VI, the plaintiffs seek to recover against their lawyers on the basis of a Maine securities law allowing recovery to a *seller* when a *purchaser* has made fraudulent

misrepresentations or omissions. 32 M.R.S.A. §§ 10,201(2), 10,605(2). This liability also extends to those who directly or indirectly control the purchaser and certain employees of the purchaser as well as brokers, dealers and sales representatives. 32 M.R.S.A. § 10,605(3). By uncontested affidavit, the lawyers have denied any such involvement. The plaintiffs now say that "it is . . . understood" that the spouse of one of the lawyers purchased some of the securities in connection with the transaction, but there is no evidence on the summary judgment record to support that assertion or any articulation of how that would bring the lawyer in question under the statute. Because this matter has been pending since January 30, 1996, there has been abundant opportunity to obtain affidavits or depositions if this issue were material and there has been no showing of why competent evidence on the subject could not be presented. Accordingly, I conclude on the record that the defendants are entitled to summary judgment on Count VI. **SO ORDERED.**

DATED THIS 3RD DAY OF JULY, 1996.

D. BROCK HORNBY
UNITED STATES DISTRICT JUDGE